

Highlights from Joint Economic Committee Hearing on Critical TARP Vulnerabilities

Hearing Date: April 23, 2009

The Special Inspector General for the Troubled Asset Relief Program (SIGTARP), Mr. Neil Barofsky, appeared today before the Joint Economic Committee in a vital hearing that brought to light the TARP's current vulnerability to fraud, abuse and mismanagement of billions of taxpayer dollars. Mr. Barofsky's testimony addressed a new report released by his office this week, and his staff's ongoing efforts to oversee the increasingly complex array of TARP-financed government programs.

Carolyn Maloney, chair of the Joint Economic Committee, opened the questioning by asking the SIGTARP about his assertion that the Public-Private Investment Partnership (PPIP) proposed by Treasury to resolve the current financial crisis is "inherently vulnerable to fraud, waste and abuse." "Can you explain the dangers you envision in more detail?" Mrs. Maloney asked. Mr. Barofsky explained that the PPIP is designed to use taxpayer dollars to leverage the purchase of toxic assets by private investors. "The fund managers, in essence, set the new prices for these securities," Mr. Barofsky explained. "A lot of discretion and frankly economic power is going to be given to a small number of fund managers. Now the conflict of interest comes into play: what if that fund manager has on its books or is managing for other clients from which it derives fees the exact same mortgage backed security that it's going to go out and buy at a higher price?"

Mrs. Maloney pressed the Special Inspector General for specific steps that could be taken to prevent such conflicts of interest and other similar abusive behavior from PPIP participants. Mr. Barofsky advised that tougher conflict of interest rules be implemented, suggesting either that entities not be allowed to bid on any toxic asset types they have on their books, or in the event this prohibition proves too sweeping and impractical, at a minimum that private entities be required to set up rigid internal walls that make collusion, price-fixing and conflicts-of-interest impossible. The Special Inspector General also emphasized the importance of total transparency in this process to discourage fraud and inspire public confidence that taxpayer money is put to good use.

The SIGTARP also testified that despite his strong and repeated recommendation that Treasury require all TARP recipients to report on their actual use of TARP funds, Treasury officials continue to resist implementing this requirement. Current TARP regulations only require use of funds accounting from Citigroup and Bank of America. A number of members of the JEC, including Congressman Robert Brady and Senator Robert Casey, pressed Mr. Barofsky on why Treasury had to date ignored this recommendation. Mr. Barofsky noted that the Treasury department worried that implementing use-of-funds monitoring requirements for TARP recipients would be overly burdensome and impractical given the fungible nature of TARP money. Mr. Barofsky however strenuously argued for the importance of instating the requirement, noting that his office had taken the initiative on this issue, asked all TARP recipients to account for their use of funds, and received a 100% response rate. Mr. Barofsky further noted that TARP recipients who had put in place internal controls to track and monitor TARP use of funds were able to provide a far more thorough accounting of how and why they spent taxpayer dollars. Chairwoman Maloney concurred with Mr. Barofsky on the vital importance of this recommendation. "On a basic level, it's absolutely critical that we know where the money has gone and how it's been used," Mrs. Maloney said.

In response to further questioning from panel members, Mr. Barofsky discussed his concerns about the expansion of the Term Asset-Backed Securities Loan Facility (TALF) to cover notoriously risky Mortgage Backed Securities. Mr. Barofsky noted that his initial February report had recommended against expanding TALF. While the SIGTARP testified that he had worked closely with Treasury on this issue and felt comfortable that meaningful safeguards were being developed to minimize taxpayer exposure, in response to Chairwoman Maloney's inquiries he still recommended against including the so-called "liar loans" – legacy mortgages and securities with inadequate underwriting standards – into the TALF program, and stressed the importance of Treasury and TALF officials looking beyond the credit ratings in evaluating the true worth of these assets.

Representative Loretta Sanchez noted Treasury's assurances that it had enough money left to fund TARP without additional Congressional appropriations relied in part on reusing the \$25 billion TARP recipients have said they are returning to the government, and asked Mr. Barofsky his view on the appropriateness of turning TARP into a financial "revolving door." Mr. Barofsky replied that as a legal matter, his understanding is that Treasury can reuse returned monies through the end of 2009.

Representative Elijah Cummings questioned Mr. Barofsky about the Administration's Making Home Affordable program, supported by \$50 billion in set-aside TARP funds. Congressman Cummings noted his concern that mortgage companies continue to foreclose on his constituents at an alarming rate, despite the fact that the Making Home Affordable program is now up and running. Mr. Barofsky noted that struggling homeowners who qualify for the program should be able to contact their mortgage servicer and participate in a 90 day trial period during which the servicer is not allowed to foreclose on their homes. If the homeowners are foreclosed upon anyway, they are the victims of fraud, and Mr. Barofsky invited them to contact his office.

Finally, Mr. Barofsky briefed lawmakers on his office's ongoing enforcement activities. His staff is currently pursuing 21 criminal investigations, and just announced the first criminal charges related to TARP. The SIGTARP also testified that he has 6 ongoing audits, including an audit of overpayments to AIG counterparties. Mr. Barofsky assured the committee the audit was on schedule to be completed, and a report released, "within the next three months." A hotline has been established, 877-SIG-2009. Mr. Barofsky emphasized to the committee that staff were in place to follow up on all tips coming through the hotline, that hundreds of calls had been received, and that fully one third of the criminal investigations currently underway were initiated as a result of hotline tips.